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Legal Aspects of Doing Business in China

China Risk, Regulations & Rewards

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Topics of Discussion

- China RoHS
- Intellectual Property Rights
- Technology Licensing
- Using Your Own Contracts
- Getting Money Out of China
- Sales and Distribution

China RoHS – Legal Ramifications



China RoHS

- *Administration Regulations on the Control of Pollution Caused by Electronic Information Products*
- Promulgated on Feb. 28, 2006
- Enter into effect on March 1, 2007
- RoHS -- “Restriction of Hazardous Substances”

China RoHS (cont'd)

- Timeline for implementation
 - 1st Phase – Marking and disclosure (from March 1, 2007)
 - 2nd Phase – Restriction of hazardous materials



China RoHS (cont'd)

- Marking & disclosure obligations
 - Environmentally friendly-use period
 - Maximum Concentration Value (MCV) of Hazardous Substances
 - Lead (Pb) <0.1%
 - Mercury (Hg) <0.1%
 - Hexavalent Chromium (CrVI) <0.1%
 - Polybrominated Biphenyls (PBBs) <0.1%
 - Polybrominated Diphenyl Ethers (PBDEs) <0.1%
 - Cadmium (Cd) <0.01%
 - Packaging materials

China RoHS (cont'd)

- Questions
 - Where to place the logo
 - How to disclose what you don't know?



Green Logo



- Applies directly to the product
- Does not contain any Hazardous Substances
- Recommended color is green, but if not aesthetically pleasing other colors are acceptable
- Product with surface area smaller than $5 \times 10^3 \text{ mm}^2$ are not required to have logo printed on the product, but the logo should be printed clearly in the documentation



Please refer to Table 1 for the names and contents of the toxic or hazardous substances or elements contained in electronic information products.

Table 1 Marking Styles for Names and Contents of Toxic or Hazardous Substances or Elements

Part Name	Toxic or hazardous Substances and Elements					
	Lead (Pb)	Mercury (Hg)	Cadmium (Cd)	Hexavalent Chromium (Cr (VI))	Polybrominated biphenyls (PBB)	Polybrominated diphenyl ethers (PBDE)

O: Indicates that this toxic or hazardous substance contained in all of the homogeneous materials for this part is below the limit requirement in SJ/T11363-2006.
 X: Indicates that this toxic or hazardous substance contained in at least one of the homogeneous materials used for this part is above the limit requirement in SJ/T11363-2006.
 (Enterprises may further provide in this box technical explanation for marking “X” based on their actual conditions.)

Environmentally Friendly-Use Period Logo







- Applies directly to the product
- Contain Hazardous Substance(s)
- The number in the middle represents the “Environmentally Friendly-Use Period”
- Declaration of present Hazardous Substance in table format
- Orange is the recommended color
- Product with surface area smaller than 5 x 103 mm² are not required to have logo printed on the product, but the logo should be printed clearly in the documentation

Marking Requirements on Packaging Materials

- GB 18455-2001

Table 1 Recycling Marks

Mark Number	Mark Name	Mark Graphic	Scope of Application of Mark
1	Reusable		Applies to all types of packaging
2	Recyclable/renewable		
3	Contains renewable materials		
4	Green point mark		Applies to all types of packaging

China Compulsory Certification (CCC)

- Products in the “Key Catalog” are banned from containing Hazardous Substances
- Pre-market testing and compliance certification associated with the RoHS Substances
- Key Catalog is expected to be published in Sep. 2007 ~ Mar. 2008

Enforcement of China RoHS

- Warning
- Seizure of non-compliant products (e.g., marking, substances)
- Fines
- Repatriation orders
- Suspension or cancellation of business license



Chart: China RoHS v. Europe RoHS

	China RoHS	EU RoHS
Implement	Directly implement	Via the state law of each members
Scope	EU RoHS Scope <u>PLUS</u> Radar, Component, Appliances, Toys ...	10 Categories
-- Exemptions	N/A	Material Application Exemptions
-- Packaging M	Non-Hazardous/ Recyclable	N/A
-- Production M	Restricted per material restrictions	N/A
Marking Requirements	Hazardous Materials Env-Friendly Use Period Packaging Materials	None
Certification Requirements	Prerequisite	Not a prerequisite

Intellectual Property Rights (IPRs)



Scope of IPR Protection

- IP rights cover product:
 - Form:
 - Patents (design)
 - Copyright
 - Contents:
 - Patents (invention/utility models)
 - Identifiers:
 - Trademarks, trade names, enterprise names
 - Information / entertainment / software:
 - Copyright

Scope of IPR protection (cont'd)

- Other protection:
 - Unfair competition
 - Trade secrets
- Regulation of IP
 - Technology licensing rules (mainly cross-border)
- Nature of protection – trademarks and patents
 - Geographical
 - First-to-file

Legislation

- Criminal enforcement:
 - Criminal Code
- Civil enforcement:
 - Trademark Law
 - Copyright Law
 - Patent Law
 - Anti-Unfair Competition Law
- Administrative enforcement

Administrative Enforcement

- Administration for Industry and Commerce, etc.
- Limited deterrence
 - Seizures / fines only
- Fines
 - Low or avoided entirely
- Akin to misdemeanor
 - But without stigma of criminal record



Civil Enforcement

- Preliminary injunctions
 - Available in theory for trademark / copyright only
 - Courts in many cities very conservative
- Asset preservation
 - Guaranteeing access to compensation
 - Ex-parte seizure of infringer funds
- Fairly fast / efficient in major cities
- Evidence collection can be difficult

Criminal Enforcement

- Handled by procuratorate, but private suit possible
- Mainly targets counterfeiting and piracy
- Effective remedy when available



Customs Recordal

- Any protected patent, trademark or copyright
- Recordal not required, but for recorded rights:
 - Customs will take ex officio action
 - Reduced security bond
 - May not need to obtain preliminary injunction from People's Court
- Confiscate infringing goods and fines



IPR Developments

- WTO accession 2001
 - Trademark, patent and copyright laws amended
 - Statutory damages up to RMB500,000 possible
 - Almost full compliance with TRIPS Agreement
 - Technology licensing rules liberalized
- Since then...
 - Law developed organically through cases
 - Counterfeiting / piracy are serious problems
 - Companies and foreign governments unhappy

Trademark Infringement Trends

- 2005 Quality Brands Protection Committee survey:
 - 60% of companies say fakes occupy 5-10% of market
 - 40% say fakes take 10-99% of market
 - 77% suffer “serious” or “very serious” export problem
- 81% of goods seized by US Customs in 2006 by value came from China





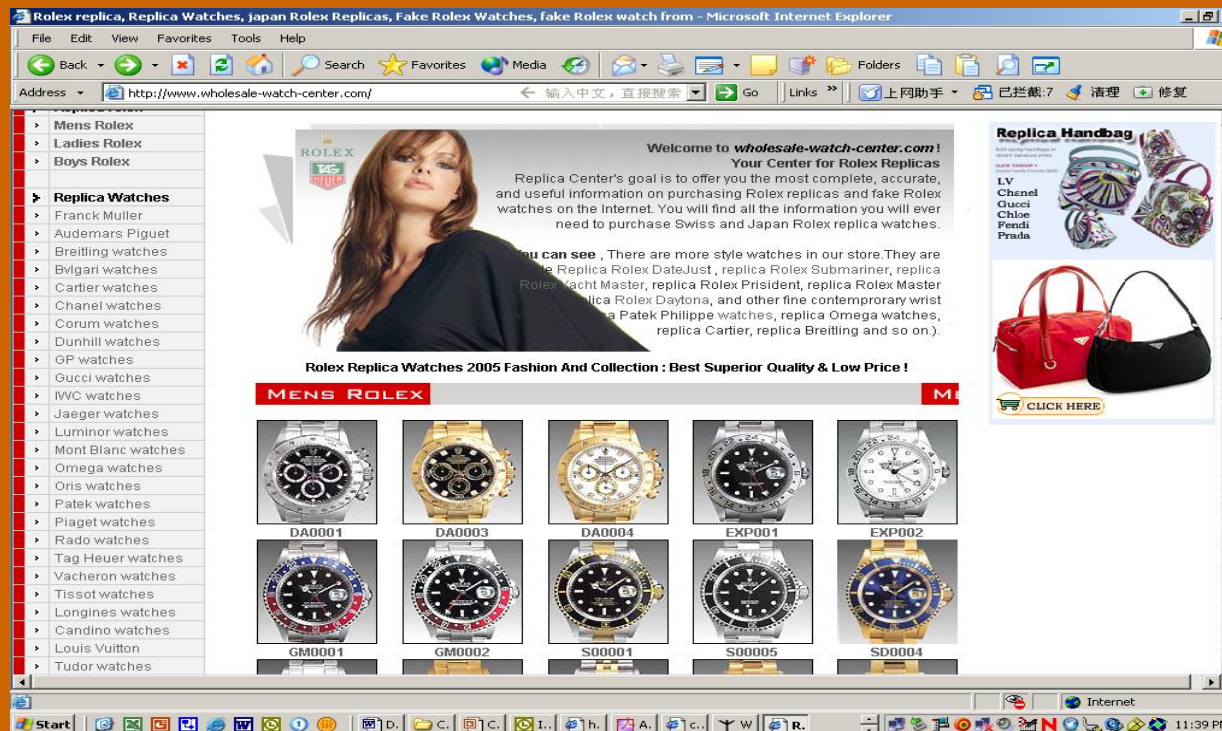
Expanding locally



And globally



Not to mention the internet...



Recent Progress

- “Action Plan” announced March 8, 2006
- National Working Group on IP Protection
- Comprehensive blueprint
- Legislation
 - New rules on administrative transfers to police
 - New rules on general customs bonds
 - New rules on IP enforcement at trade fairs
 - Consultation with industry on TM / copyright law revision
- New national police unit dedicated to IP crimes

What can you realistically achieve through enforcement in China?

Realistic Strategies

- Civil actions:
 - Compensation starting to be viable: statutory damages up to RMB500K
 - Asset preservation available – subject to payment of bond of 100%
 - Evidence preservation / preliminary injunctions: worth a try, but unreliable
- Criminal enforcement:
 - Increasingly viable and cost-effective
 - But still require significant budget (US\$20-100K)
- Administrative raids:
 - Always there and generally cheap (US\$3-10K)
 - But limited deterrence
- Combining measures:
 - AIC raid, then seek damages through negotiations or civil action
- Retailers and underground factories
 - Target the landlord



Case Study – Landlord Liability



Case Study: Landlord Liability

- “Silk Market” litigation (2004-2005)
 - April 2006 decision by Beijing appeal court for five luxury brands
 - Confirmed liability for landlords where:
 - Actual notice given of infringing outlets
 - Infringements continue
- June 2006 MOU with three landlords
 - Two landlords cooperating
 - Support from EU, MOFCOM, Mayor
- Silk Market being difficult
 - They sued lawyer, claiming he lacked POAs
 - Required s to obtain legalized POAs

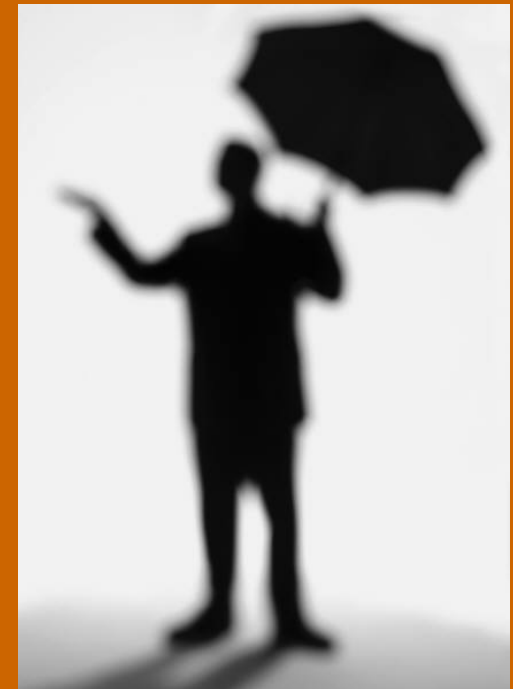
Trade Secrets

- Assume the worst
 - You may lose what you introduce to China
- But companies not enforcing their rights
- Industry not lobbying for legal reforms



Trade Secret Protection – Best Practices

- Show reasonable steps taken to protect confidentiality
 - Documents stamped “confidential”
 - Tight restrictions in employment contracts
 - Physical access to secrets restricted
 - Training
- Cultivate local police
- Be prepared to prove direct losses
- Be prepared to disclose technology to authorities

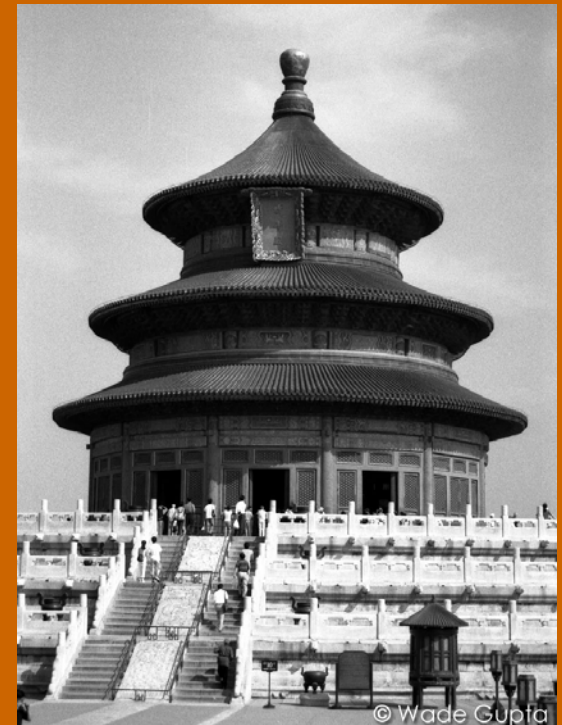


Technology Licensing



Cross-Border Technology Licensing

- Regulations for the Administration of the Import/Export of Technology
 - Broad scope:
 - Know-how, patents, trademarks, copyrights, etc.
 - Licenses, assignments, co-development, technical services, etc.
 - Prohibited, restricted and freely tradable technology
 - Mandatory, prohibited and negotiable clauses



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“Restricted” Technology

- Steps required to import:
 1. Apply to MOFCOM for technical review
 2. MOFCOM reviews (30 days)
 3. If approved, sign contract
 4. MOFCOM reviews contract (10 days)
 5. If approved, MOFCOM issues technology import license (“effective date”)
 6. Register contract online (<http://info.ec.com.cn>)



“Freely Tradable” Technology

- Steps required to import:
 1. Sign contract (“effective date”)
 2. Register contract online
 3. Submit hard copy to MOFCOM
 4. MOFCOM issues technology import registration certificate
- In either case, imports of commercial technology with the “core function” to protect encryption prohibited except for self-use upon approval



Mandatory and Prohibited Clauses

- Mandatory:
 - Ownership or right to license
 - Complete, accurate, effective and capable of achieving objectives
- Prohibited:
 - Unnecessary ancillary conditions
 - Unreasonable restrictions on sourcing, production or exports
 - Barring competitive technology
 - Prohibiting improvements



Negotiable Clauses

- Negotiable:
 - Confidentiality
 - Governing law
 - Dispute resolution
- Now “liberalized”:
 - Royalties
 - Term
 - Post-termination restrictions



Using Your Own Contracts



Using Your Own Contract -- Adaptation, Localization, Translation

- To meet mandatory requirements under Chinese laws and regulations
- To secure your rights and limit your liabilities
- Choice of law (local choice of law v. mandatory laws)
- Dispute resolution



Changes to Contract Clauses

- Regulatory
 - Form and/or content drivers
 - Approval/registration requirements
 - Foreign exchange
 - Tax
 - Intellectual property laws
 - Product quality and consumer protection laws
 - Restrictions on competition

Changes to Contract Clauses (cont'd)

- Confidentiality
 - Protection of proprietary trade and business information
 - Adopt measures to maintain confidentiality
 - Non-disclosure agreement



Changes to Contract Clauses (cont'd)

- Other Provisions
 - US law-driven provisions
 - Software licenses v. sales
 - Level of payment and technical detail in contract
 - License grant wording
 - Liquidated damages
 - Termination

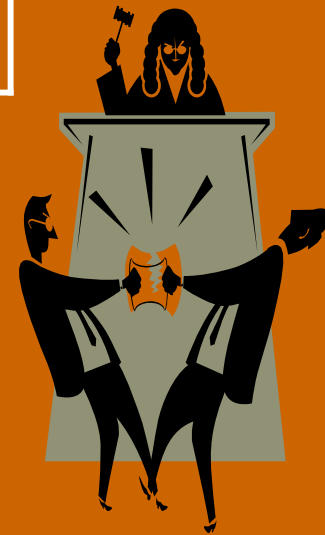
Governing Law

- Contracts governed by foreign v. PRC law
- For a “contract with a foreign element”, unless otherwise provided by law (limited exceptions), parties are free to choose governing law
- UN Sale of Goods Convention
- Laws of the place where the chosen forum located (i.e. Hong Kong law)

Dispute Resolution – Litigation v. Arbitration

Court Judgments	Bilateral Treaties
Arbitration Awards	New York Convention (1987)
Service of Judicial Documents	Hague Convention (1965)

- IP carve-out – preliminary injunction
- Non-exclusive jurisdiction
- No discovery



Dispute Resolution - Arbitration

- Key elements for a valid arbitration clause
 - Writing
 - Agreement of Arbitration (exclusive jurisdiction)
 - Place of arbitration
 - Name of the arbitration commission
 - Arbitration rules
- Domestic arbitration (CIETAC, CMAC)
- Foreign arbitration (ICC, LCIA, AAA)
- Hong Kong arbitration (HKIAC)

Dispute Resolution – Hong Kong, Macao and Taiwan (different legal regions (法域))

	Hong Kong	Macao	Taiwan
Court Judgments	Bilateral Arrangement	Bilateral Arrangement	SPC Regulations / TW Regulations
Arbitration Awards	Bilateral Arrangement	No Agreement	Same as above
Service of Judicial Documents	Bilateral Arrangement	Bilateral Arrangement	No Agreement / Arrangement

Dispute Resolution – Bilateral Treaties between Mainland and Hong Kong/Macau SARs

- Recognition of monetary judgments
- Circumstances of non-recognition
 - Exclusive jurisdiction
 - Earlier proceedings on the same matter
 - Judgments or arbitration awards concerning the same matter already recognized or enforced
 - Improper procedures
 - Judgments not effective yet or whose enforcement is suspended
 - Public interest

Dispute Resolution – Bilateral Treaties between Mainland and Hong Kong/Macau SARs (cont'd)

- Time limit: according to the rules of the court of application (Article 20)
 - In Mainland: 1 year if one or both of the parties are natural persons and 6 months if both parties are legal persons or other organizations (Article 219)
 - In Macao: no time limit
- Court cost and enforcement cost: applicant to pay according to rules of court of application (Article 19)

Getting Money Out of China



Getting Money Out of China

- China's Foreign Exchange Regime
 - Inflow and outflow of foreign exchange (forex)
 - Conversion of forex to and from local currency (Renminbi or RMB)
 - Currency used for pricing and settlement of transactions in China

Getting Money Out of China (cont'd)

- Administering forex - players
 - People's Bank of China (PBOC) announces RMB exchange rates; buyer/seller of last resort
 - State Administration of Foreign Exchange (SAFE) drafts laws on trading, settlement, etc., monitors forex bank accounts, and approves individual forex transactions
 - Designated foreign exchange banks (DFXBs) serve as the gateway for forex to flow in and out of China

Getting Money Out of China (cont'd)

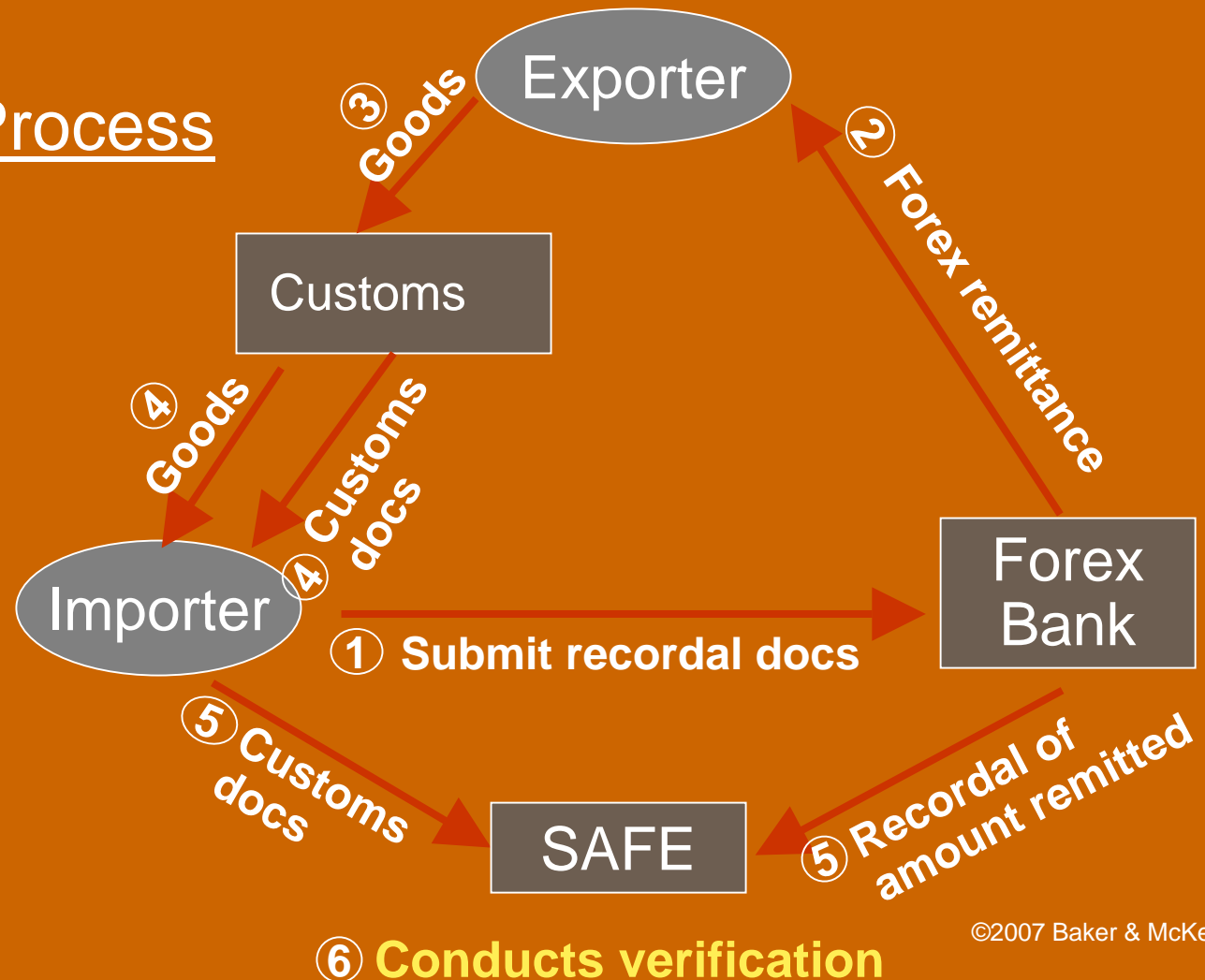
- Four types of transactions subject to control
 - Inward remittance (汇入境内): a party outside China remits forex into China
 - Settlement (结汇): a party in China sells forex in exchange for RMB
 - Sale (售汇): a party in China pays RMB to buy forex
 - Payment (付汇): a party in China remits forex out of China

Getting Money Out of China (cont'd)

- Forex payment for imports
 - No need for transaction-by-transaction approval, but there are recordal and ex-post verification requirements
 - To remit funds abroad, must submit documentary proof that the transaction is valid
 - E.g. import contract, invoice, etc.
 - Once goods clear customs, must submit customs documentation within 30 days for “verification”

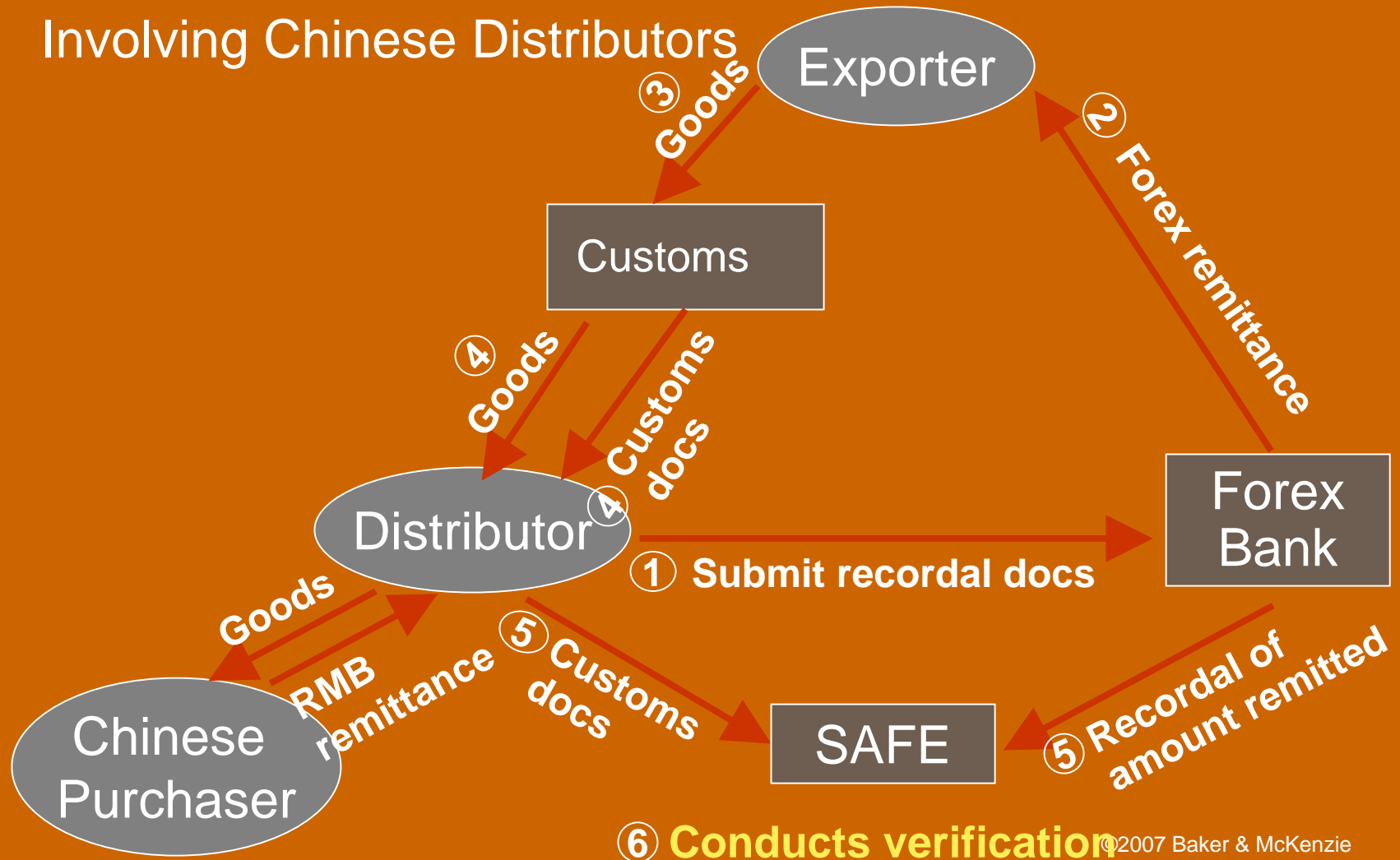
- Forex Payment for Imports

Six-step Process



• Forex Payment for Imports

Involving Chinese Distributors



Getting Money Out of China (cont'd)

- Forex payment for technology transfer fees
 - Scope of technology import contracts
 - Patent transfers, application right transfer, or license
 - Proprietary technology license or transfer
 - Computer software license
 - Trademark license or transfer embedded within a patent or proprietary technology license
 - Technology service or consultancy
 - Cooperative design, research, development or production

Getting Money Out of China (cont'd)

- Forex payment for technology transfer fees (cont'd)
 - Documents required
 - Written application
 - Transactional documents
 - Invoice or request of payment
 - Registration or approval documents
 - With other authorities in charge as applicable
 - Patent: recordal certificate issued by the State Patent Administration
 - Trademark: recordal certificate issued by the State Trademark Administration
 - Computer software: recordal certificate issued by provincial copyright bureau

Getting Money Out of China (cont'd)

- Forex payment for technology transfer fees (cont'd)
 - Registration or approval documents
 - With foreign trade authority (MOFCOM)
 - Technology import license (for restricted technology) or technology import contract registration certificate (for freely tradable technology)
 - Data Form for Technology Import Contract
 - Recordal Form of Data Change for Technology Import Contract

Getting Money Out of China (cont'd)

- Forex payment for technology transfer fees (cont'd)
 - Registration or approval documents
 - With other authorities in charge as applicable
 - Patent: recordal certificate issued by the State Patent Administration
 - Trademark: recordal certificate issued by the State Trademark Administration
 - Computer software: recordal certificate issued by provincial copyright bureau

Getting Money Out of China (cont'd)

- Forex payment for royalties (other than technology transfer fees)
 - Process substantially the same as technology transfer fees, except:
 - No registration or approval from foreign trade authority is required
 - Recordal certificates from copyright, cultural, film, or trademark authorities are the only required registration or approval documents
 - BUT, tax is higher -- no business tax exemption

Getting Money Out of China (cont'd)

- Forex payment for service fees
 - Depending on the nature of the services, approval or registration may be required
 - No approval or registration required for
 - Advertising fees
 - Consulting fees (excluding technology consulting)
 - Fees for attending exhibits

Sales and Distribution



“Doing Business in
China”...

“One Billion
Customers”



Sales and Distribution – Cross-Border

- No presence in China
 - Sales to agent or distributor in China; or
 - Direct sales to customer
- Advantages
 - Agent or customer responsible for Customs and value-added tax (VAT)
 - Agent or customer responsible for complying with local regulatory requirements
 - Receive payment directly in US dollars
 - Can use US law and arbitration

Sales and Distribution – Cross-Border (cont'd)

- Challenges
 - Forex payments require detailed documentation
 - Contract registration or approval?
 - Tax clearance certificate
 - Characterization of sale
 - Goods, services or software
 - Stationing employees in China without a registered presence
 - Limitations on foreign employees traveling to China
 - Requirement to establish a representative office
 - Individual income tax obligation
 - Local independent agent or deemed employee?
 - Permanent establishment

Sales and Distribution – Presence in China

- All foreign establishments in China -- registration or approval/registration required
 - Legalized documents
 - Office space with signed lease; no shelf companies or virtual offices
 - Identified representatives/directors/supervisors
 - Subsidiaries require a formal business plan and articles of association
 - Post-registration procedures required to open bank accounts and begin operations
 - Summary: budget time to complete tasks

Sales and Distribution – Representative Office

- Advantages:
 - A sales liaison office with broad promotional scope
 - Defined tax liability
 - Station and hire employees in China
- Challenges:
 - No collecting of payments, issuing invoices or signing contracts with customers
 - Stationing service personnel in representative office is problematic
 - Risks of operating outside scope
 - Fine, reprimands, revocation of the license and reputation risks
 - Tax exposure

Sales and Distribution – Foreign-Invested Commercial Enterprise (FICE)

- Engage in “trading”: wholesale or retail sales, sales agency and ancillary services
- Advantages:
 - Buy in foreign currency and sell to Chinese customers in local currency
 - Customer receives VAT or business tax invoice
 - Customer has no foreign exchange, Customs or import-stage VAT obligations
 - Ancillary services include advertising, warehousing and broad range of support services for products

Sales and Distribution – FICE (cont'd)

- Challenges
 - May require higher level of approval – more time to establish
 - Qualify as a general VAT tax-payer (or input VAT cannot be deducted)
 - Not eligible for tax incentives
 - Combining sales with production or R&D – may lose incentives

Sales and Distribution – Online Sales and Services

- Servers outside China
 - Sales and services from outside China are generally not regulated
- But how does the customer pay?
 - Credit card may be possible for online consumer purchases
 - Otherwise customer must apply for foreign exchange remittance
- Business tax and enterprise income tax may be withheld on services - 60% rule
- Is it a license? - business tax and withholding tax

Sales and Distribution – Online Sales and Services (cont'd)

- Servers inside China
 - Sales and services from a server inside China are regulated
 - Also, if invoicing and collecting in local currency (RMB), usually treated as if server located inside China
- Basic and value-added telecoms (VAS) services
 - Foreign investment restricted to 49% or 50% respectively
 - Joint venture with local partner
 - Nominee arrangement
 - Basic: E.g., fixed network and mobile cellular communications
 - VAS: E.g., online data processing and transaction services; call centers

Sales and Distribution – Online Sales and Services (cont'd)

- Examples of other services requiring licenses or prohibited to foreign investment
 - Encryption technology
 - Internet security
 - Payment services



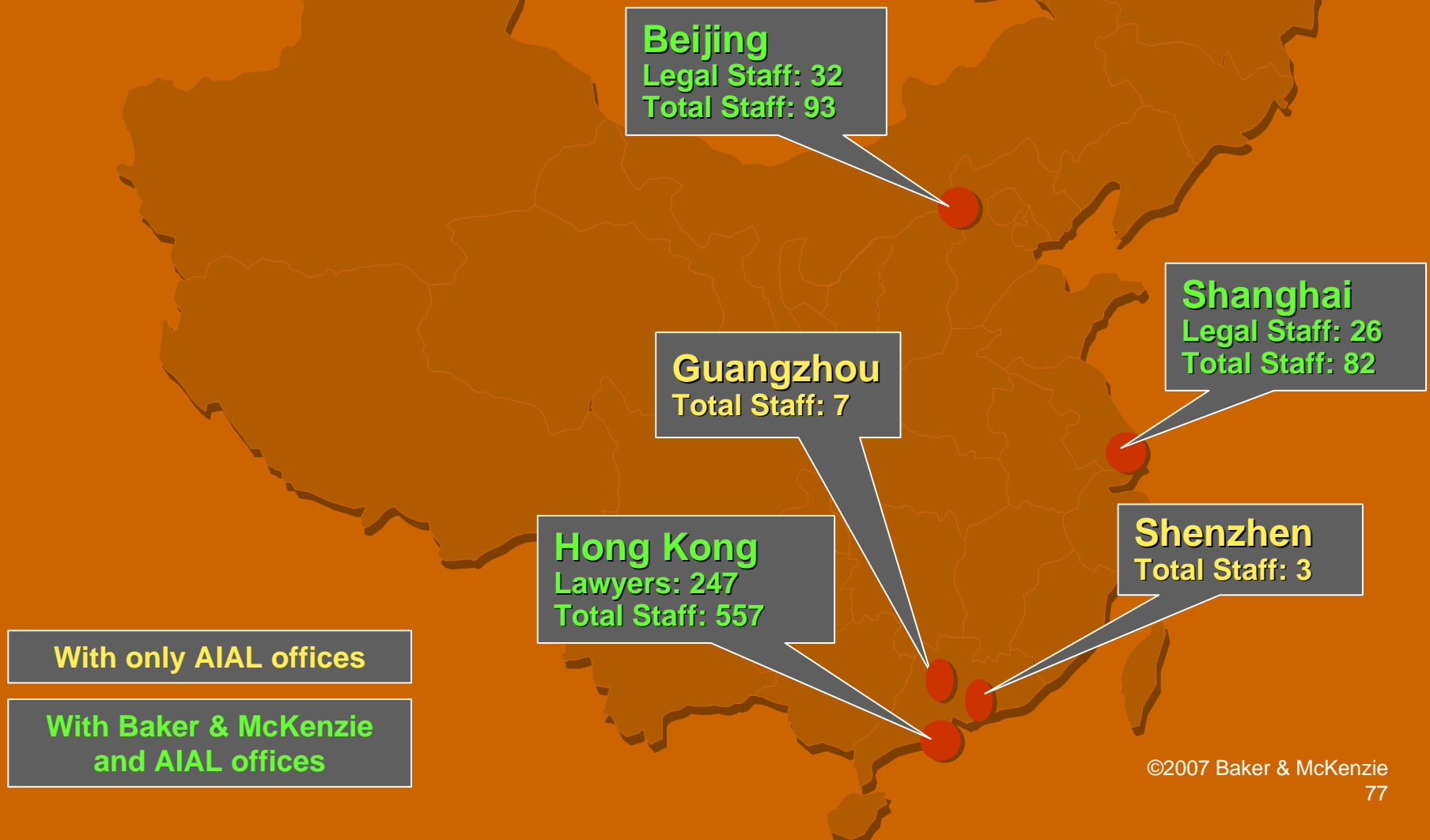
Sales and Distribution – Online Sales and Services (cont'd)

- Commercial internet information services (CIIS) v. non-CIIS
 - CIIS -- compensated provision to online subscribers through the internet of information services -- requires permit
 - Non-CIIS – requires recordal only
- Effect
 - Companies established in China can market and sell products and services within their business scope over the internet and provide related telephone support
 - But must have permit to market and sell other products or provide telephone call-center support services

Sales and Distribution – Sales of Online Services and Software

- Scenario – Subsidiary in China sells software or services provided from offshore affiliate
- Challenge – How to compensate affiliate?
- Solutions
 - FICE can import software through Customs and resell subject to VAT in China
 - Master license from affiliate will add business tax and withholding to cost
 - Provider in China of services located on offshore server can pay offshore affiliate provider service fee under subcontract
 - But onshore provider must have license to sell services (VAS, etc.) in China

Baker & McKenzie in China



Awards and Accolades

China Client Choice Award – *International Law Office* 2006, 2005

Tax & Trusts Law Firm of the Year – *ALB Hong Kong Law Awards* 2006, 2005, 2004, 2003, 2002

China IP Firm of the Year – *Managing Intellectual Property Awards* 2006

Hong Kong IP Firm of the Year – *AsiaLaw IP Awards* 2006, 2005, 2004

PRC Labour Lawyer of the Year – *China STAFF HR Awards* 2004, 2002, 2001, 1999

China Practice of the Year – *ALB Hong Kong Law Awards* 2004, 2005
PLC Which Lawyer? Directory 2006, 2005
ALB China Law Awards 2004

Ranked #1 Legal Advisor by Widest Coverage – *M&A Asia* 2005, 2003, 2002, 2001

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– *Asia Pacific Legal 500*

Questions?

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